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SURFACE TRANSPORTATION BOARD

DECISION

STB Finance Docket No. 34509

KAW RIVER RAILROAD, INC.
– ACQUISITION AND OPERATION EXEMPTION –
THE KANSAS CITY SOUTHERN RAILWAY COMPANY

Decided: May 3, 2005

On May 25, 2004, Kaw River Railroad, Inc. (KRR) filed a notice of exemption to acquire by lease, sublease, and assignment (herein, the agreements), and to operate as a common carrier, a total of 18.2 miles of track in Kansas City, KS, and Kansas City, MO. By separate petitions, the Brotherhood of Locomotive Engineers and Trainmen, a Division of the Rail Conference, International Brotherhood of Teamsters (BLET), and the United Transportation Union (UTU) request that we hold a hearing in connection with the proceeding, schedule an oral argument, and reject KRR's notice or revoke the exemption. For the reasons set forth below, we will deny the relief sought.

PROCEDURAL BACKGROUND

By verified notice filed on May 25, 2004, and served and published in the Federal Register on June 24, 2004 (69 FR 35424-25), KRR, a noncarrier, sought to acquire by lease, sublease, and assignment from The Kansas City Southern Railway Company (KCS) and to operate, respectively, 7.5 miles of trackage owned by KCS, 4.5 miles of trackage owned by the Kansas City Terminal Railway Company (KCT) but leased and operated by KCS, and 6.2 miles of trackage owned by KCT over which KCS possessed operating authority. On May 27, 2004, BLET filed a petition to stay the effectiveness of the exemption. KRR replied to the petition for stay on May 28, 2004. On that same date, the Board denied the stay request for failure to meet the criteria for a stay. The exemption took effect on June 1, 2004. KRR had stated that it would begin common carrier operations on or after that date.

BLET filed a petition to revoke the exemption on June 4, 2004. UTU filed a virtually identical petition to revoke 10 days later. Both BLET and UTU served discovery requests upon KCS and KRR pursuant to 49 CFR 1121, and each stated that it would supplement its petition to revoke upon completion of discovery. On June 24, 2004, KRR replied to the petitions, urging that the Board reject them for failure to include information to support revocation and for failure to state how the requests meet the standards for revocation at 49 U.S.C. 10502(d).

Following discovery, and the Board's handling of related procedural matters, BLET and UTU filed supplemental petitions to revoke on August 16, 2004. On September 8, 2004, KCS filed its reply to the supplemental petitions, and KRR filed a reply, along with a motion to strike portions of BLET's supplemental petition. BLET replied in opposition to the motion to strike on September 28, 2004. Also on September 28, 2004, BLET filed a petition for leave to introduce additional evidence, for a hearing to examine a witness who verified the factual assertions made in KRR's reply to the supplemental petitions (or to strike that filing), and for an oral argument. UTU advised the Board on October 13, 2004, that it supported BLET's September 28 petition. On October 18, 2004, KCS filed a reply opposing oral argument, while KRR filed a reply opposing BLET's requests for a hearing and an oral argument.

PRELIMINARY MATTERS

KRR argues that BLET has presented evidence and argument in its supplemental petition that could have, and should have, been presented in BLET's initial petition to revoke. It thus requests that we strike all portions of BLET's supplemental petition not involving information or materials adduced through discovery. BLET responds that, for the sake of administrative convenience and for the purpose of submitting at one time a comprehensive argument in support of its request for revocation, its supplemental petition should be accepted as filed.

We will not strike BLET's supplemental petition to revoke. Although the Board's rules at 49 CFR 1121.3(c) contemplate submission of evidence and argument to the fullest extent practicable in the initial petition, we recognize the advantages of receiving a fully developed petition after discovery has been concluded. Moreover, KRR has been able to respond fully to BLET's supplemental petition, and thus has not been prejudiced either by the content of BLET's filing or by the manner of its submission. For these reasons, we will deny KRR's motion to strike.

BLET and UTU seek a hearing to examine KRR's witness, Arthur E. McKechnie III, with respect to certain assertions in KRR's reply. Along with its hearing request, BLET filed supplemental evidence and argument intended to rebut statements that BLET attributes to Mr. McKechnie. In the absence of a hearing, BLET asks that we strike Mr. McKechnie's statement.

We will accept the additional evidence included in BLET's September 28, 2004 filing, but will deny BLET's and UTU's requests for a hearing and for an oral argument.

Mr. McKechnie signed a one-sentence statement verifying the factual assertions in KRR's reply, not the legal arguments contained therein. Nevertheless, the union's request for a hearing focuses on two assertions – (1) that the track in question is excepted track under 49 U.S.C. 10906, and (2) that the transaction is a sham because KRR will not be providing, or cannot provide, common carrier

service. Under the circumstances, deposing Mr. McKechnie as to either point would serve no purpose. As we discuss below, whether the Board has jurisdiction over a transaction does not depend upon the past operational status of the involved trackage. Thus, in light of our precedent, further exploration of the past status of the track would have no bearing on our decision.

In addition, because KRR, KCS, and KCT furnished petitioners with the various agreements which govern this transaction, the unions already possess the materials that would indicate whether KRR can provide common carrier service. The unions have relied upon those materials here. The parties have enjoyed a full and fair opportunity to obtain discovery from one another and develop a complete record. Moreover, in light of our acceptance of BLET's post-reply evidence and argument, petitioners have not demonstrated that they would be prejudiced if unable to examine Mr. McKechnie. For these reasons, we will not grant petitioners' request for a hearing to examine Mr. McKechnie, nor will we strike Mr. McKechnie's verification or KRR's reply to the supplemental petitions to revoke.

Finally, the record is sufficient for us to reach an informed decision on the basis of the written submissions. The petitions to revoke do not raise issues that are novel. Holding an oral argument appears unlikely to yield additional relevant information. Thus, we will deny the request to hold an oral argument.

POSITIONS OF THE PARTIES

BLET's Petition to Revoke and Supplemental Petition to Revoke

BLET argues that this transaction does not fall within the class exemption KRR has invoked. That is because, in BLET's view, it involves switching track that is excepted from the Board's licensing authority by 49 U.S.C. 10906. Also, BLET contends that, because certain KCS positions will be eliminated as a result of the transaction, the transaction warrants greater Board scrutiny than that available under the class exemption procedures.

In its supplemental petition, BLET characterizes KRR's notice of exemption as a "scam" to use the agency's processes to change KCS's collective bargaining agreements without following the Railway Labor Act's processes. BLET Supplemental Petition to Revoke at 7. BLET also expands upon its argument in its petition that the transaction involves excepted switching track. BLET maintains that, even if some of the track may have been operated by other railroads as a "line of railroad" requiring Board authority to operate, KRR provides only switching service, and those operations should dictate the tracks' status. Furthermore, BLET argues that KRR is not holding itself out to the public as a common carrier because KRR is not "invading" KCS territory (id. at 15), but is merely providing a contract switching service as KCS's alter ego.

BLET criticizes Effingham Railroad Company – Petition for Declaratory Order – Construction at Effingham, IL, STB Finance Docket No. 41986 (STB served Sept. 12, 1997) (Effingham), aff'd sub nom. United Transp. Union-Illinois Legislative Board v. STB, 183 F.3d 606 (7th Cir. 1999), on which the Board relied in denying BLET's request to stay the transaction. BLET characterizes the Effingham decision as "an aberration, which should not be followed here." Id. at 14.

Finally, BLET maintains that, even if this transaction were otherwise appropriate for handling under the class exemption, the Board should revoke the exemption as to this transaction because certain KCS employees will be harmed by the transaction. According to BLET, 18 engineer and switchman jobs in the Kansas City terminal have already been lost. The union also asserts that KRR's exemption should be revoked to carry out the Rail Transportation Policy of 49 U.S.C. 10101 (RTP), particularly the policy considerations set forth at 49 U.S.C. 10101(11) (to encourage fair wages and safe and suitable working conditions in the railroad industry). In arguing that the transaction is contrary to the RTP, BLET maintains that it would fail to satisfy the "public convenience and necessity" standard that would govern the acquisition and operation of a rail line by an entity that is not already a carrier under 49 U.S.C. 10901.

For these reasons, BLET requests that we either reject KRR's notice or revoke its exemption.

UTU's Petition to Revoke and Supplemental Petition to Revoke

UTU's initial petition to revoke contains language almost identical to that found in BLET's initial petition. In its supplemental petition, UTU, like BLET, argues that the KRR transaction "is nothing but a sham formulated by [KCS] to evade its collective-bargaining agreement obligations." UTU Supplemental Petition to Revoke at 2. In support of that claim, UTU points to several provisions in the agreements underlying the KRR transaction as evidence that KRR is merely the alter ego of KCS, and that the KRR notice of exemption is therefore false and misleading. Among the provisions of the agreements that UTU cites are the following: KCS will deliver cars to KRR in the same blocking as KCS would have done in the absence of an interchange; KCS will perform, manage, and supervise the maintenance and repair of all signals, grade crossing equipment, and communications systems along the KRR-operated trackage; KCS must approve KRR's service plan and any changes to KRR's levels of service; and KRR will utilize KCS's Management Control System. According to UTU, "nothing has changed regarding this operation [as a result of the transaction] except for the name of the company and the employees operating the KCS locomotive." Id. at 4.

KRR's Response to the Petitions to Revoke

In reply, KRR argues that the Board correctly relied upon Effingham in denying BLET's stay petition, and that Effingham requires that KRR's exemption be upheld. Moreover, KRR asserts that all

of the shippers it will serve are new to KRR, that it will serve two shippers (DaVinci Roofing Materials and Express Sand & Gravel) that were not receiving service from KCS, and that KRR will interchange new traffic with at least three Class I railroads. KRR maintains that a substantial amount of the track in question has already been found to be subject to the licensing requirements of the Interstate Commerce Act in a separate proceeding, The Atchison, Topeka and Santa Fe Railway Company and Gateway Western Railway Company – Lease Exemption – Kansas City Terminal Railway Company, Finance Docket No. 32238 (ICC served Feb. 24, 1994).

KRR also challenges petitioners' assertion that the tracks at issue are switching tracks excepted from the Board's licensing requirements. KRR states that some of the track over which it operates is main line trackage not falling within the scope of section 10906. Further, to the extent that some of the tracks may have been used by KCS as yard or switching tracks, KRR argues that it is not KCS's prior use of the trackage that dictates the current status of that trackage but, rather, KRR's intended use of the tracks in common carrier service.

Additionally, KRR responds that BLET has not articulated any basis for the Board to revoke the notice as contrary to the RTP. In so doing, KRR emphasizes its understanding that "no employee of KCS is unemployed as a result of this transaction." KRR Reply to Supplemental Petitions to Revoke at 20.

KRR argues that the various provisions of its agreements with KCS that UTU cites as evidence of a sham transaction are, to the contrary, "quite common in agreements between Class I railroads and their shortline partners, particularly in transactions involving the lease, rather than the sale, of rail lines." Id. at 12. Moreover, KRR maintains that many of the questioned provisions have been found to be acceptable in prior agency proceedings. Id. at 13-18. KRR also specifically identifies, at pp. 17-18 of its reply, a number of track lease and sublease provisions to demonstrate its independence from KCS. KRR denies that KCS exercises undue control over it, stating that it is independent of, and not affiliated with, KCS, and that it operates under its own name with its own employees, management, and equipment.

KCS's Response to the Petitions to Revoke

KCS states that no KCS employee has lost employment with KCS as a result of this transaction. According to KCS, all of the employees that used to perform the work that is now being done by KRR employees remain employed by KCS, with the exception of one employee who decided to quit the railroad rather than transfer to another job on KCS. KCS Reply to Supplemental Petitions to Revoke at 5.

KCS states that it "does not own, control, supervise, direct, or otherwise treat KRR as its 'agent.'" Id. at 7. Although it acknowledges that it has a close working relationship with KRR, KCS asserts that the contractual relationship between the two railroads is essentially no different than KCS's relationships with other shortline railroads with which it connects. KCS argues that, because KRR is not its agent, the transaction covered by KRR's notice of exemption is not a sham and does not violate KCS's collective bargaining agreements with its employees.

DISCUSSION AND CONCLUSIONS

Under the Board's section 10901 class exemption process, 49 CFR Part 1150 Subpart D, KRR has been authorized to acquire the track at issue here by lease, sublease, and assignment and to operate over it as a common carrier. BLET and UTU now ask the Board to reject KRR"s already-effective exemption notice or to revoke the exemption. But they have not shown why KRR's notice was not proper; nor have they shown grounds for revocation of the exemption pursuant to 49 U.S.C. 10502(d).

The unions basically assert two grounds. The first is that the track in question is switching track under 49 U.S.C. 10906 and not track under 49 U.S.C. 10901. The second is that the transaction is a sham.

KRR intends to hold itself out as a common carrier, and its acquisition that is the subject of this proceeding required our authorization. The new operation made possible by this transaction constitutes KRR's entire line of railroad. KRR holds out service to the public, and all of its customers are new to it. Accordingly, this track is encompassed by 10901, and KRR therefore needed to obtain Board authority to commence operations.

KRR would have needed such authority even if the track in question could have been characterized as switching track under 10906 when operated by the previous operator, KCS. Under Effingham, a noncarrier must obtain authority under section 10901, or an exemption from the formal requirements of that provision, to conduct common carrier rail operations. Merely characterizing the proposed operations as switching does not relieve a rail operator of the obligation to obtain a Board license if the operator is holding out common carrier service to the public over a line of railroad.

UTU argues that the Board should not follow Effingham here because it views Effingham as an aberration — an unwarranted departure from longstanding precedent. But Effingham, and the tenant-

use test upon which it is based, reflect a well-established interpretation of 49 U.S.C. 10901 that has been judicially affirmed[1] and applied in many Board proceedings.[2]

The Board has authorized numerous transactions under our class exemption processes where, as here, a noncarrier entity would become a rail carrier by virtue of its lease and operation of tracks owned by another entity.[3] In many such instances, the tracks to be leased and operated in common carrier service were previously excepted tracks under section 10906 or private tracks beyond the

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[1] United Transp. Union-Illinois Legislative Board v. STB, 183 F.3d 606 (7th Cir. 1999); United Transp. Union-Illinois v. STB, 169 F.3d 474 (7th Cir. 1999) (UTU-Illinois); Brotherhood of Locomotive Eng'rs v. STB, 101 F.3d 718 (D.C. Cir. 1996).

[2] See, e.g., Ohio Valley Railroad Company – Acquisition and Operation Exemption – Harwood Properties, Inc., STB Finance Docket No. 34486 (STB served Sept. 28, 2004) (Ohio Valley); Bulkmatic Railroad Corporation – Acquisition and Operation Exemption – Bulkmatic Transport Company, STB Finance Docket No. 34145, slip op. at 4 (STB served May 15, 2003); Texas Central Business Lines Corporation – Operation Exemption – MidTexas International Center, STB Finance Docket No. 33997 (STB served Sept. 20, 2002) (Texas Central); Central Illinois Railroad Company – Lease and Operation Exemption – Lines of The Burlington Northern and Santa Fe Railway Company at Chicago, Cook County, IL, STB Finance Docket No. 33960 (STB served Sept.12, 2002) (Central Illinois); GWI Switching Services, L.P. – Operation Exemption – Lines of Southern Pacific Transportation Company, STB Finance Docket No. 32481 (STB served Aug. 7, 2001) (GWI Switching); Clark Shortline Railroad Company – Acquisition and Operation Exemption – Indiana Port Commission, STB Finance Docket No. 32112 (STB served May 14, 1998); Penn-Jersey Rail Lines, Inc. – Acquisition and Operation Exemption – WMI Properties, Inc., STB Finance Docket No. 33414 (STB served Dec. 8, 1997) (Penn-Jersey).

[3] See, e.g., Northern Lines Railway, LLC – Lease and Operation Exemption–The Burlington Northern and Santa Fe Railway Company, STB Finance Docket No. 34627 (STB served Jan. 6, 2005); Tazewell & Peoria Railroad, Inc. – Lease and Operation Exemption – Peoria and Pekin Union Railway Company, STB Finance Docket No. 34544 (STB served Sept. 28, 2004); Pennsylvania Southwestern Railroad, Inc. – Lease and Operation Exemption – J&L Specialty Steel, LLC, STB Finance Docket No. 34328 (STB served Apr. 24, 2003); Central Columbiana & Pennsylvania Railway, Inc. – Lease and Operation Exemption – Columbiana County Port Authority, STB Finance Docket No. 33818 (STB served Dec. 23, 1999); Diamond State Port Railway Company, Inc. – Lease and Operation Exemption – Diamond State Port Corporation and F.A. Potts & Company International, Inc., STB Finance Docket No. 33755 (STB served June 25, 1999) (Diamond State).

Board's licensing authority,[4] and, in some cases, the tracks in question were previously used as switching or yard tracks by a prior operator, just as was the case here.[5]

Next UTU contends that the transaction is a sham or that KRR is KCS's alter ego, but the evidence does not support such a claim. Notwithstanding the importance of switching service to them, line haul carriers often prefer to concentrate on providing line haul service and to rely on other carriers to provide switching or other feeder line service. Often, the industries that receive such service prefer to deal with a local switching carrier. UTU's claim that the agreements change nothing but the operator's name and the identity of the employees overlooks the fact that KRR is a financially independent business entity that is unaffiliated with KCS. See G&MV R. Co. – Exempt. – Consolidated Rail Corp., 9 I.C.C.2d 1249, 1255 (1993) (where financial independence is present, shared facilities and coordination of operations carry little weight in demonstrating that one carrier is the alter ego of another). UTU has failed to show that KRR is a mere front or has entered into the agreements for any reason other than to obtain the benefit of the terms contained therein.

Nor do the provisions of the agreements demonstrate that KRR is merely an alter ego of KCS. The contracts between the two carriers give KCS influence over the KRR's performance. That practice is reflected in provisions of the agreements noted by UTU, such as the provisions that: (1) require KRR to meet service standards approved by KCS, (2) preclude KRR from reducing service without KCS consent, and (3) provide that KCS may require KRR to improve service. These provisions are not unusual in a contract between a switching carrier and the line haul carrier with which it connects. The line haul carrier is dependent on the switching carrier for its customers. If the switching carrier loses customers due to high rates or poor service, those customers are also lost to the line haul carrier, which typically earns substantial revenue from them.

Other provisions of the agreement demonstrate KRR's independence. KRR will provide maintenance on the leased tracks, may make up trains for the BNSF Railway Company and for the Union Pacific Railroad Company as well as for KCS, and may solicit new customers in its own name. KRR will continue at present to maintain the same switching schedules used by KCS. And KRR and KCS will share some recordkeeping to facilitate the interchange of traffic between the two carriers.

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[4] See, e.g., Ohio Valley; Texas Central; GWI Switching; Penn-Jersey; Diamond State.

[5] See, e.g., Central Illinois; GWI Switching. Cf. Chicago Rail Link, L.L.C. – Lease and Operation Exemption – Union Pacific Railroad Company, STB Finance Docket No. 33323 (STB served Sept. 7, 1997) (approving use of class exemption by an existing Class III carrier from the provisions of 49 U.S.C. 10902 to acquire by lease and operate certain switching or yard tracks in Chicago owned by Union Pacific Railroad Company), aff'd sub nom. UTU-Illinois.

But KRR will provide its own locomotives — after an initial period when it will use those of KCS — and KRR is responsible for day-to-day operations on the lines.

Moreover, UTU has not shown that KRR was created exclusively for the purpose of evading labor agreements, as would be required to demonstrate that KRR is the alter ego of KCS. See FRVR Corporation – Acquisition and Operation Exemption – Chicago and North Western Transportation Company, Finance Docket No. 31205, slip op. at 6 (ICC served Feb. 28, 1989) (FRVR Corp.) (discussing alter ego test). Contrary to UTU's argument, the Track Lease Agreement is not automatically negated if it turns out that the carrier must obtain a labor contract agreement from the affected labor unions; rather, it simply provides that, if any labor agreements with affected crafts are deemed necessary, the Track Lease Agreement is contingent upon obtaining such agreements. But even if the Lease were set up so that it would be negated by a labor contract requirement, in FRVR Corp., the agency found that similar conditions are a reasonable method for a potential purchaser to protect itself in the event that expanded labor start-up costs threaten the viability of the new enterprise. Id. at 6-7 (internal citations omitted). As explained above, valid commercial reasons exist for this transaction and for the terms and conditions that govern it.

Finally, we see no need to revoke KRR's exemption as inconsistent with the public convenience and necessity. To obtain a revocation, the petitioner must demonstrate that greater regulatory scrutiny is necessary to carry out the RTP. Here, the concern expressed by BLET is that KCS positions will be eliminated, thus harming KCS employees. But the statute makes clear that labor protections cannot be imposed on acquisitions by noncarriers under section 10901. 49 U.S.C. 10901(c). And we see no basis for finding that the labor impacts are so severe as to warrant greater regulatory scrutiny for the transaction through a more formal process, as opposed to allowing it to proceed under the class exemption procedures. Indeed, BLET has failed to show that the labor impact here is different in character from or greater in degree than the impacts typically associated with the acquisition of track by a new carrier. In any event, KCS offered new positions elsewhere on the KCS system to all of the employees whose positions were eliminated, and all but one chose to accept a new position. BLET has not rebutted either the presumption in 49 U.S.C. 10901(c) that such acquisitions are consistent with the public convenience and necessity, or the presumption reflected in the class exemption that such acquisitions do not warrant detailed Board scrutiny to carry out the RTP. Accordingly, we find no basis to revoke KRR's exemption.

This decision will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. KRR's request to strike portions of BLET's supplemental petition to revoke is denied.

2. BLET's and UTU's requests for a hearing in this proceeding are denied.

3. BLET's and UTU's requests for an oral argument in this proceeding, or, in the alternative, to strike Mr. McKechnie's verification of KRR's reply to the petitions to revoke, are denied.

4. BLET's and UTU's petitions to reject KRR's notice of exemption or, in the alternative, to revoke KRR's exemption are denied.

5. This decision is effective on its date of service.

By the Board, Chairman Nober, Vice Chairman Buttrey, Commissioner Mulvey.

Vernon A. Williams
Secretary